

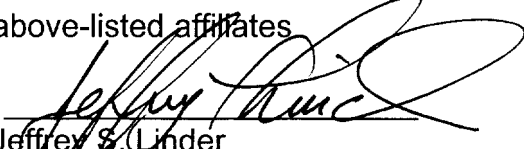
IV. CONCLUSION

The *FNPRM* addresses a number of important legal and practical issues regarding the availability of telecommunications services to unserved and underserved areas, particularly tribal lands. Substantial progress in improving service availability to these areas will not be realized, however, unless federal, state and tribal authorities (where applicable) work together to implement rational support mechanisms. Adopting a competitive bidding mechanism is an important first step in this process and one that the Commission should undertake in this proceeding. In addition, the Commission should ensure that the Lifeline program appropriately addresses the unique circumstances faced by consumers living on tribal lands by promoting the availability of second and third tier Lifeline support.

Respectfully submitted,

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above-listed affiliates

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Auction Proposal for Universal Service GTE

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ATTACHMENT A

Why an Auction?




■ Market solution for setting support levels

- » Ends arguments over cost models
 - Bids reflect bidders' own cost expectations
- » Ends argument about revenue benchmarks
 - Bids reflect any follow-on revenue bidders expect
- » Moves away from cost-of-service regulation


■ Assures that support is sufficient


- » Firms, not commission, specify support amount

Why an Auction? 2

- 
- Promotes efficient supply
 - » Identifies low cost suppliers
 - Helps minimize need for support
 - Corrects any errors in initial support levels
 - Adjusts to changes over time
 - » Technology, input prices, definition of universal service
 - » Eliminates need to update cost models

Who Would Conduct the Auctions?

- 
- Cooperative effort by FCC and states
 - » Single auction for each small area to determine both Federal and State support
 - FCC establishes guidelines; states participate on voluntary basis
 - » If state-sponsored auction meets FCC guidelines, then FCC shares responsibility with state to fund support determined by auction
 - Auction administrator could be state staff, FCC staff, or third party



Background and Prerequisites

Context for the Auction



Commission must define item to be auctioned

» COLR obligation in a small area

■ Winner must be allowed to win

» CLEC winning auction acquires obligation

■ Loser must be allowed to lose

» Losing ILEC must lose obligations and support

– *Includes resale and unbundling obligations*

» Allows for exit

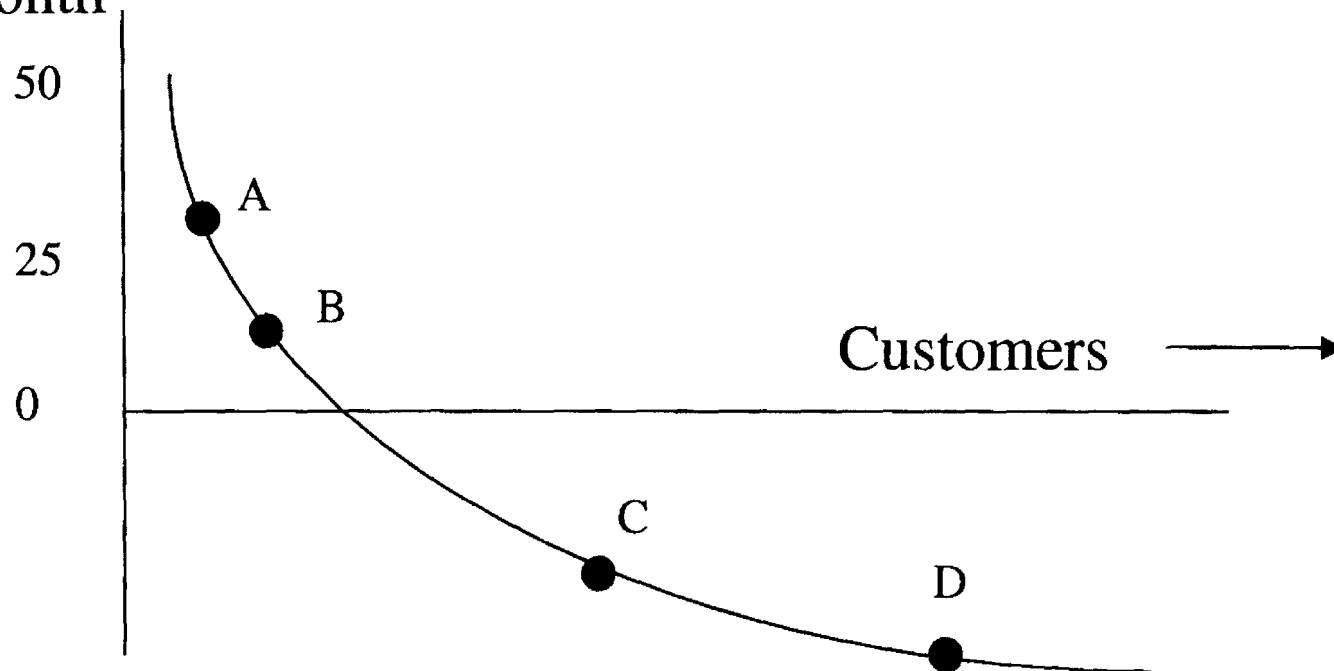
Context for the Auction, 2




- For competitive neutrality, each COLR in an area must have
 - » Same obligation
 - » Same support
- COLR must offer service package that:
 - » Includes defined universal service
 - Can include other features; allows for “hybrid” service
 - » Is affordable
 - Price no higher than ceiling set by state

Ordering of Customers within a Service Area, By Support Need


■ Support Needed,
\$/month




Why an Obligation to Serve?

- 
- **Customers within an SA are heterogeneous**
 - » Some variation in cost
 - » Large variation in demand, revenue
 - **Support must be an average amount for SA**
 - » Not practical to calculate exact support for each customer
 - **In absence of obligation, less desirable customers will not be served**
 - » If only ILEC has obligation, others will cherry-pick more desirable customers (C and D), leave less desirable customers (A and B) for ILEC
 - » Support will be insufficient for ILEC, even if correct on average

Initial Support Levels

- 
- Based on comparison of cost and rates for defined local service
 - Available to ILEC prior to auction
 - When new firm enters and nominates area for bidding, auction is held
 - » Auction result replaces initial support

Auction Elements

- 
- Certification of Qualified Bidders
 - Determination of Areas to be Auctioned
 - Auction Rules
 - Post-Auction Implementation

Certification of Qualified Bidders



- Carrier must be an Eligible Telecommunications Carrier (“Eltel”)
- Must be willing to undertake COLR obligation specified by state PUC
- PUC may wish to verify bidder’s capability to perform as COLR

Auction Design Objectives



Objectives considered in optimization:

- Promote competition “in the market” where feasible:
 - » Ex post competition among COLRs
- Promote efficient supply
 - » By choosing most efficient firms
- Keep support as low as possible
 - » Auction allows competition “for the market”
 - » To minimize deadweight losses

Auction Design Objectives, 2




■ Other design objectives:

- » Avoid collusion
- » Simplify administration and bidding
- » Assure competitive neutrality “for” and “in” the market
- » Allow for withdrawal of incumbent COLRs
- » Choose COLRs for unserved areas

■ Already mentioned:

- » Assure sufficiency
- » Correct support that is too high or too low
- » Reflect changes over time in costs, technology, service definition



Nominations, ILEC Exit and Bidding

Nomination of Areas for Bidding



- **Twice yearly window for Qualified Bidders (“QB”) to nominate areas**
 - » Each QB may nominate any number of small areas (“SA s”)
 - » QB deposits \$1000 per area nominated , refundable if the QB submits a valid bid
- **Nominations not accepted for SAs auctioned within last three years**
 - » If auction changed number or identity of COLRs
- **If there is only one COLR (e.g., the ILEC) in an SA, it may not nominate the SA, except by applying to exit (see next slide).**

ILEC Exit



- **After nominations are closed and announced, a sole COLR may apply to exit.**
- **If the sole COLR applies to exit, the CPUC asks if any other QB is willing to become COLR at current support level.**
 - » If more than one QB volunteers, these QBs enter an auction
 - The current COLR is excluded
 - The reserve is equal to the current support level
 - » If one QB volunteers, then
 - That QB becomes COLR at current support level
 - ILEC receives no support and loses COLR obligations
 - » If no takers, the SA is deemed nominated for auction

State PUC Tasks




- **PUC may nominate some areas on its own motion in limited circumstances**
 - » Initially, in areas where multiple COLRs already receive support
 - » At any time, for unserved areas
- **After nominations, CPUC publishes list of SAs and firms who nominated them**
 - » Announces reserve support level for each SA
 - Reserve is a multiple of the current support level
 - » Opens window for firms to register for bidding

The Bidding Process




- Single round, sealed-bid auction
 - » Less vulnerable to collusion
 - » Simpler for administrators and for bidders
- Separate bids for each SA
- Form of bid is per-customer support amount

The Bidding Process,2

- 
- Each bidder submits two bids:
 - » First element is per customer amount QB would need if it were the only COLR
 - » Second element is the per customer amount QB would need if it shared COLR obligation with other carriers
 - Two elements allow auction to reflect carriers' economies of density

Determination of Winners

- 
- Lowest bidder is QB submitting lowest first element
 - » Lowest bidder is declared a COLR


 - Other bids accepted if within specified range of lowest bid
 - » Determined by comparing other bidders' second element with lowest bid

Determination of Winners, 2

■ To determine if other COLRs are accepted :

- » 1) If the second element of at least one competing bid does not exceed the lowest first element by more than 15% of the sum of the lowest bid and the basic service price, then any bid whose second element falls within that range will be accepted
- » 2) If no competing bids are in the range described in 1, but at least one bid is within 25% of the sum of the lowest bid and the basic service price, the two lowest bidders will be declared COLRs
- » 3) Otherwise, only the lowest bid is accepted

Determination of Winners, 3

- 
- Acceptance rule accepts more bids when bids are close together
 - » Allows benefit of competition “in the market” when cost, in additional support, is low
 - » When bids are far apart, the cost of having more COLRs is greater, so fewer COLRs accepted
 - Commission can vary the tradeoff among policy goals by choosing different parameters
 - » Wider range: more COLRs, but higher cost
 - » Narrower range: lower cost, but fewer COLRs

Determination of Support Amount




- **All firms whose bids are accepted receive same support per customer**
 - » Achieves competitive neutrality among COLRs “in the market”
- **Support is at level of highest accepted bid**
 - » Ensures that support is sufficient
 - No carrier has to serve at less than its bid
 - » Outcome similar to competitive market
 - “price” is set by a marginal firm
 - » Does not affect expected value of support
 - Bidders adjust their bids according to payment rule

Bid Withdrawal Rules



- Once auction results are announced, bidders are given an option to withdraw
 - » Lowest bidder gets first option, others in sequence
 - » Support is recomputed as though withdrawn bids had not been made
 - » Withdrawal cannot leave SA without a COLR

Exceptions

- 
- If there are no qualified bids, or if the ILEC is the sole bidder, then the ILEC continues as COLR and receives
 - » the original support level, if it did not apply to exit
 - » the reserve price, if it did apply to exit

Post-Auction Implementation



■ Assumption of COLR obligations

- » If no change of COLRs, new support applies 10 days after close of auction
 - If there is a change of COLR, new support applies 10 days after date of change
- » If COLR is newly designated, then maximum transition period is:
 - 90 days if ILEC is also COLR
 - One year if ILEC is not COLR

Post-Auction Implementation,2



■ Measures to ensure performance

- » New COLRs post bond when auction results announced
- » Halfway through transition period, new COLR submits implementation plan to PUC
- » Substantial penalties for non-performance
 - Financial penalties
 - Carrier barred from future auctions

Post-Auction Implementation,3



■ Terms of COLR Obligation

- » **If auction results in change in the number and identity of COLRs, no new nominations accepted for 3 years**
 - Establishes term of “contract” between PUC and COLR --
Allows bidder to plan recovery of investment
- » If auction does not change identity or number of COLRs, area can be nominated at next 6 month window
 - No protection for ILEC if it is the only winner

Changes to COLR Obligation



- Commission may review and modify COLR obligation, including basic service definition
 - Subsequent auctions will be based on COLR obligation posted at time of nomination
 - Existing COLR obligations are not affected until area is rebid
 - Reserve should reflect modified obligation

Transfer of COLR Obligation



- Any COLR may transfer or sell its obligation to any other QB at any time
- But transfer cannot reduce the number of COLRs in an area

Market Factors That Affect Auction Design




■ Synergies

- » Cost of being COLR in area A may depend on whether carrier is also COLR in area B


■ Economies of Density

- » Cost depends on how many COLRs share market

Auction Design to Accommodate Synergies

- 
- GTE's proposed auction design makes some provision for synergies:
 - » Bids within a given range accepted
 - » Option to withdraw
 - » Ability to transfer COLR obligations after auction
 - More complex design could more fully account for synergies

Auction Design to Accommodate Economies of Density



- Each bidder submits two bids
 - » Second bid reflects bidder's estimate of difference in cost if it must share market with other COLRs
- Lowest bidder is firm with lowest first element; others accepted if their second element is within range of lowest bid
- Support based on highest accepted bid
 - » Design prevents gaming; lowest bidder is compensated based on highest accepted bidder's estimate of economies of density